

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF MALUTI-A-PHOFUNG LOCAL MUNICIPALITY FOR THE YEAR
ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of Maluti-a-Phofung Local Municipality which comprise the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with Statements of Generally Recognised Accounting Practice (Statements of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial Statements*, requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by Maluti-a-Phofung Local Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis for disclaimer of opinion

Closing balances

5. The final trial balance that agrees with the financial statements differed by a net amount of R503 428 345 from the accounting system as year-end corrections were not effected on the financial system. Satisfactory explanations were not provided for this difference and alternative procedures could not be performed to determine the reason for the differences and I was not able to verify the accuracy of these differences.

Property, plant and equipment

6. The asset register was the only record of assets held by the municipality that supported the property, plant and equipment amounting to R629 396 801 as disclosed in the statement of financial position and note 4 to the financial statements. No alternative procedures could be performed where the asset register did not provide appropriate audit evidence. Due to the following matters, the register is not considered to be a reliable record of property, plant and equipment and as a result I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation and presentation and disclosure of and the municipality's rights to property, plant and equipment. This was as a result of insufficient procedures by management to address the reliability of the asset register.
 - (a) Numerous assets in the asset register with a carrying value of R595 655 830 could not be physically identified for inspection while items to the value of R5 370 013 (2008: R3 081 583) were assigned duplicate numbers in the asset register. I was thus unable to obtain sufficient appropriate audit evidence as to the existence of these items of property, plant and equipment. No alternative procedures could be performed to obtain appropriate audit evidence.
 - (b) The existence of and municipality's rights to assets totalling R75 000 000 (2008: R75 000 000) that were transferred from the former Qwa-Qwa government to the municipality and that I have reported on since 1994, as well as assets acquired to the value of R3 101 837 (2008: R11 907 804) for which sufficient appropriate evidence could not be submitted, could not be confirmed.
 - (c) The opening carrying value of property, plant and equipment as reflected in the statement of financial position and note 4 to the financial statements was R243 265 832 less than the carrying value of property, plant and equipment per the asset register as accumulated depreciation and carrying values are not reflected in the asset register. The valuation of property, plant and equipment could thus not be confirmed.
 - (d) The valuation of accumulated depreciation, as well as the accuracy of depreciation for the year could not be confirmed. Recalculations indicated a difference of R18 931 496 that could not be resolved.

Trade and other receivables

7. Included under other debtors amounting to R147 201 940 in note 13 to the financial statements is a cash suspense account with a balance of R112 286 061. The entries in this account must be matched to unallocated bank deposits that are disclosed in the unallocated direct deposits account that form part of cash and cash equivalents in the statement of financial position as reported in paragraph 12 of this report. The municipality did not implement sufficient processes and procedures to monitor and clear these accounts on a regular basis and I was unable to obtain sufficient appropriate audit evidence regarding the valuation of the municipality's rights and obligations relating to this cash suspense account.
8. Due to inefficiencies in the safeguarding of documentation of the municipality I was unable to obtain sufficient appropriate audit evidence in respect of debtors with a balance of R3 057 509 that were included in the balance of other debtors in the statement of financial position. I was unable to confirm the valuation of this amount and the lack of documentation prevented me from performing alternative procedures to obtain appropriate audit evidence.
9. Included in other debtors in the statement of financial position are expenses of R2 839 875, which do not constitute a recoverable asset for the municipality as they represent expenditure payable by the municipality. I was unable to obtain sufficient appropriate audit evidence regarding the rights and obligations of these balances and a lack of information prevented me from executing alternative procedures to obtain appropriate audit evidence for this matter.
10. The balance of impairment for trade and other receivables disclosed in note 15 to the financial statements amounted to R398 908 178 and I was unable to obtain sufficient appropriate audit evidence to confirm the valuation thereof. The transactions processed on the balance also did not provide appropriate audit evidence to enable me to perform alternative procedures.
11. Also included in other debtors in note 13 to the financial statements is a salary suspense account of R6 652 359 that was not cleared as at the financial year-end. As a result receivables reflected in note 13 were overstated and employee costs reflected in the statement of financial performance were understated by this amount.

Cash and cash equivalents

12. The clearing of the unallocated direct deposits account included in cash and cash equivalents in note 16 to the financial statements did not take place regularly, as reported in paragraph 7. I was unable to confirm the existence, completeness and valuation of this balance amounting to R239 176 435 (2008: R372 122 154) and the municipality's records did not allow for alternative procedures to be performed.

Revenue

13. Due to the inefficiencies in the safeguarding of supporting documentation I was unable to obtain sufficient appropriate audit evidence in support of journals amounting to R4 656 770 (2008: R2 812 353) that related to property rates income in the statement of financial performance. I was not able to confirm the occurrence

and accuracy of these amounts and due to a lack of information I was also not able to perform alternative procedures to obtain assurance.

14. The calculation of property rates was incorrect as a result of incorrect tariffs used in a number of instances and this resulted in property rates being undercharged by R42 473 255 and in the prior year it was overcharged by R13 101 753. This resulted in property rates income and receivables being understated by the said amount in the current financial year and similarly and overstated in the prior year.

Expenditure

15. I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, accuracy and cut-off for the following expenditure due to inefficiencies in the safeguarding of supporting documentation and could not perform alternative procedures due to the lack of alternative evidence:

- (a) Water and electricity purchases to the amount of R15 886 432 included in the statement of financial performance.
 - (b) General expenditure amounting to R2 843 341 and repairs and maintenance amounting to R5 441 560 included in the statement of financial performance.
 - (c) Expenditure amounting to R11 686 308 and credit notes amounting to R2 141 256 that relate to the comparative figures.
 - (d) Journals amounting to R6 073 398 that relate to general expense accounts.
16. Included in expenditure in the statement of financial performance were transactions of a capital nature to the amount of R5 918 682 that should have been capitalised as property, plant and equipment. This classification error results in the overstatement expenditure and understatement of property, plant and equipment understated by this amount. This would also result in the understatement of the accumulated depreciation and the depreciation charge as reported in paragraph 6(d) of this report.

Trade and other payables

17. I could not obtain sufficient appropriate audit evidence to confirm the completeness, existence and valuation of trade and other payables disclosed in the statement of financial position totalling R159 944 300 (2008: R15 168 398). Appropriate audit evidence could not be obtained to confirm third party payments amounting to R3 162 173. This was due to insufficient management oversight and the financial system of the municipality did not make provision for alternative procedures to confirm this amount. Due to the inefficiencies in the safeguarding of supporting documentation appropriate audit evidence could also not be obtained with regard to debit journals of R19 773 986 and credit journals of R72 532 124 (2008: Net amount of R15 168 398) that are included in the balance of trade and other creditors. Alternative procedures could not be performed to confirm this amount due to the lack of information.

Grants and subsidies

18. The grants and subsidies received from the Department of Minerals and Energy reflected in the statement of financial performance were R1 700 570 more than the amount received reflected on the bank statements and grants received from Department of Water Affairs and Forestry were R1 130 290 less than the amounts received reflected on the bank statement. The differences could not be explained by management. I was unable to confirm the occurrence and accuracy of these amounts by means of alternative procedures.
19. The total grants and subsidies received for the current year in the statement of financial performance were R26 235 880 more than the grants and subsidies received according to allocations in the Division of Revenue Act (DoRA). The classification of this amount could not be confirmed due to the lack of clarification by the institutions that transferred the amounts to the municipality. Alternative procedures could not be performed due to a lack of further information.

Value-added tax

20. The completeness and valuation of the VAT accounts included in the statement of financial position and note 14 to the financial statements amounting to R20 836 721 could not be confirmed as no reconciliations were performed by management for these accounts. I was not able to perform reasonable alternative procedures due to a lack of supporting information for these accounts.

Accumulated surplus

21. Paragraph 5 of the 2007-08 audit report indicated that there were journals of R25 722 549 which resulted in an understatement of the accumulated surplus. As also detailed in paragraphs 20 and 21 of the 2007-08 audit report, supporting documentation and narrations to journals did not present an adequate audit trail to substantiate debit transactions amounting to R12 500 000. Sufficient appropriate audit evidence could still not be submitted in order for me to confirm the occurrence, completeness and accuracy of the amounts.

Related parties

22. No supporting documentation could be obtained for the disclosure of related parties in note 42 to the financial statements. The completeness and accuracy of the information disclosed could not be confirmed. I was unable to perform alternative procedures to confirm the completeness and accuracy due to the lack of information and I could not determine the effect on the disclosures contained in the financial statements.

Fruitless and wasteful expenditure

23. The municipality was eligible to claim VAT of R2 604 196 (2008: R342 223) on expenditure incurred, but did not claim it at the date of this report. This resulted in fruitless and wasteful expenditure that was also not disclosed as required by section 125(2)(d) of the MFMA. These amounts were identified by the audit and not by the municipality's systems of internal controls and therefore I cannot confirm the completeness of the amount disclosed above.

Irregular expenditure

24. The irregular expenditure disclosed in note 49 of the financial statements amounting to R881 568 (2008: R645 235) was not identified by the systems of internal controls of the municipality. The amount was revealed during the audit and an additional amount of R868 897 was also revealed which is regarded as irregular expenditure. I was therefore unable to confirm the completeness of irregular expenditure that was disclosed in the financial statements as well as compliance with the disclosure requirements of section 125(2)(d) of the MFMA which requires the disclosure of irregular expenditure in the financial statements. The systems of the municipality are of such a nature that I was unable to perform reasonable alternative procedures to confirm the completeness of irregular expenditure.

Contingent Liabilities

25. I was unable to confirm the completeness and accuracy of contingent liabilities disclosed in note 41 of the financial statements due to a lack of information provided by management on the information disclosed. Due to the lack of information I was unable to perform reasonable alternative procedures to confirm the existence, completeness and valuation of and the municipality's obligations to the contingent liabilities.
26. In terms of GRAP 19, *Provisions, contingent liabilities and contingent assets*, (GRAP 19) the municipality must provide for the future value of the cost to rehabilitate the landfill sites for which it is responsible. No provision was made in the financial statements to comply with the requirements of GRAP 19. I was unable to perform alternative procedures to determine the extent of the non-disclosure in the financial statements.

Cash flow statement

27. I was not able to determine whether the cash flow statement and the related notes are fairly stated due to the material effect on the cash flow statement and related notes of scope limitations and identified misstatements as reported in the paragraphs above.

Disclaimer of opinion

28. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

I draw attention to the following matters on which I do not express a disclaimer of opinion:

Going concern

29. As indicated in note 15 to the financial statements, consumer debtors outstanding increased by R23 718 393 from the previous year to R106 729 089 after consideration of the impairment thereof. The difficulties being experienced by the municipality in recovering debts due to it, as well as the potential negative effect of this tendency on the cash flows of the municipality, indicate that there is a risk that the municipality may be exposed to serious financial problems, which will increase the municipality's dependence on the annual funding arranged by the Division of Revenue Act, 2008 (Act No. 20 of 2008) (DoRA). The accounting officer's report also highlights in paragraph 2 his concern regarding the municipality's dependence on grants.

Restatement of corresponding figures

30. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of errors discovered during 2009 in the financial statements of the Maluti-a-Phofung Local Municipality at, and for the year ended, 30 June 2008.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

31. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1, *Presentation of Financial Statements*. The supplementary budget information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Material inconsistencies in other information included in the annual report

32. The annual report contained material errors and some of the information was inconsistent with the annual financial statements in respect of trade and other receivables from exchange transactions, expenditure, grants received and revenue.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

33. The following information required by section 17 was not included in the budget when tabled:

- information regarding any proposed amendments to the municipality's integrated development plan
- proposed amendments to the budget-related policies
- service delivery agreements or material amendments to existing service delivery agreements
- details of the proposed cost for the budget year to a municipal entity under the sole control of the municipality.

34. Section 65(2)(e) requires the municipality to pay all invoices received within 30 days after receipt of the invoices. A number of payments totalling R4 000 572 were identified where the municipality did not comply with this requirement of the act.

35. Section 75 requires that certain information, including the annual report, be placed on the website of the municipality. Section 21A of the Municipal Systems Act, 2000 (Act No. 32 of 2000) states that if the municipality does not have a website it should disclose the required information on an organised local government website sponsored by the National Treasury. I was unable to obtain evidence of management's compliance to these prescripts of the act.

Governance framework

36. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

37. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

| Par. No. | Basis for qualified opinion | CE | RA | CA | IC | M |
|----------|-------------------------------|-----|----|----|----|---|
| 5 | Closing balances | | | 3 | | |
| 6 | Property, plant and equipment | 7 | | 6 | 1 | |
| 7 – 11 | Trade and other receivables | 1,7 | | 6 | | 1 |
| 12 | Cash and cash equivalents | 2 | | | | |
| 13 – 14 | Revenue | 2 | | 6 | | |
| 15 – 16 | Expenditure | 1,2 | | 3 | | 1 |
| 17 | Trade and other payables | 1 | 2 | | | |
| 18 – 19 | Grants and subsidies | | | 3 | | |

| Par. No. | Basis for qualified opinion | CE | RA | CA | IC | M |
|----------|------------------------------------|----|----|----|----|---|
| 20 | Value-added tax | | | 5 | | |
| 21 | Accumulated surplus | | | 3 | | |
| 22 | Related parties | | | 4 | | |
| 23 | Fruitless and wasteful expenditure | 1 | | 3 | | |
| 24 | Irregular expenditure | | | 3 | | 1 |
| 25 – 26 | Contingent liabilities | | | 3 | | |
| 27 | Cash flow statement | | | 3 | | |

Overall reflections on the governance framework based on internal control deficiencies

38. There was a lack of leadership from senior management to monitor staff's execution of their responsibilities in all departments that impacted on the audit and financial reporting processes. This was influenced by the vacancy of the accounting officer's position in the latter part of the financial year.
39. Information systems did not support financial reporting in all instances due to problems experienced during the conversion to the new financial application.
40. Proper oversight by those in charge of governance (which includes the council and audit committee) did not take place in all respects. This resulted in insufficient implementation, improvement and monitoring of systems of internal control.

| Legend | |
|---|---|
| CE = Control environment | |
| The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting. | 1 |
| Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting. | 2 |
| Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel. | 3 |
| Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting. | 4 |
| The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control. | 5 |
| Management's philosophy and operating style do not promote effective control over financial reporting. | 6 |
| The entity does not have individuals competent in financial reporting and related matters. | 7 |
| RA = Risk assessment | |
| Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting. | 1 |
| The entity does not identify risks to the achievement of financial reporting objectives. | 2 |
| The entity does not analyse the likelihood and impact of the risks identified. | 3 |
| The entity does not determine a risk strategy/action plan to manage identified risks. | 4 |
| The potential for material misstatement due to fraud is not considered. | 5 |
| CA = Control activities | |
| There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation. | 1 |
| General information technology controls have not been designed to maintain the integrity of the information system and the security of the data. | 2 |
| Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed. | 3 |
| Actions are not taken to address risks to the achievement of financial reporting objectives. | 4 |
| Control activities are not selected and developed to mitigate risks over financial reporting. | 5 |
| Policies and procedures related to financial reporting are not established and communicated. | 6 |
| Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system. | 7 |

| IC = Information and communication | |
|--|---|
| Pertinent information is not identified and captured in a form and time frame to support financial reporting. | 1 |
| Information required to implement internal control is not available to personnel to enable internal control responsibilities. | 2 |
| Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel. | 3 |
| M = Monitoring | |
| Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting. | 1 |
| Neither reviews by internal audit or the audit committee nor self-assessments are evident. | 2 |
| Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken. | 3 |

Key governance responsibilities

41. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

| No. | Matter | Y | N |
|---|---|---|---|
| Clear trail of supporting documentation that is easily available and provided in a timely manner | | | |
| 1. | No significant difficulties were experienced during the audit concerning delays or the availability of requested information. | | X |
| Quality of financial statements and related management information | | | |
| 2. | The financial statements were not subject to any material amendments resulting from the audit. | | X |
| 3. | The annual report was submitted for consideration prior to the tabling of the auditor's report. | | X |
| Timeliness of financial statements and management information | | | |
| 4. | The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA. | X | |
| Availability of key officials during audit | | | |
| 5. | Key officials were available throughout the audit process. | X | |
| Development and compliance with risk management, effective internal control and governance practices | | | |
| 6. | Audit committee | | |
| | • The municipality had an audit committee in operation throughout the financial year. | | X |
| | • The audit committee operates in accordance with approved, written terms of reference. | | X |
| | • The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. | | X |
| 7. | Internal audit | | |
| | • The municipality had an internal audit function in operation throughout the financial year. | X | |
| | • The internal audit function operates in terms of an approved internal audit plan. | X | |
| | • The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. | X | |
| 8. | There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management. | | X |
| 9. | There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations. | | X |
| 10. | The information systems were appropriate to facilitate the preparation of the financial | | X |

| No. | Matter | Y | N |
|--|---|---|---|
| | statements. | | |
| 11. | A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA. | | X |
| 12. | Powers and duties have been assigned as set out in section 79 of the MFMA. | X | |
| Follow-up of audit findings | | | |
| 13. | The prior year audit findings have been substantially addressed. | | X |
| 14. | SCOPA resolutions have been substantially implemented. | | X |
| Issues relating to the reporting of performance information | | | |
| 15. | The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete. | X | |
| 16. | Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information. | | X |
| 17. | A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Maluti-a-Phofung Local Municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA | X | |
| 18. | There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance. | X | |

Overall reflections on the governance framework based on other key governance requirements

42. The attitude of staff towards responsibilities and external audit resulted in information not being readily available for review and recommendations and resolution not being addressed timeously. The preparation of the financial statements was outsourced as a result of a lack of capacity and skills. These financial statements were subjected to material amendments resulting from the audit and were revised eight times as a result of the underlying accounting records of the municipality being insufficient and errors made by the consultants. The lack of leadership by senior management structure of the municipality and the departments involved in the financial and performance reporting contributed to this situation as corrective action was not taken to ensure that staff complied with the requirements of the reporting and the audit process.
43. The absence of a functioning audit committee and a lack of intervention by the council to ensure that its own and the municipality's oversight functions are working resulted in insufficient actions being taken to address risks and internal control weaknesses.
44. Information systems did not support financial reporting in all instances due to a lack of assigning responsibility to a person as well as monitoring by senior management of the implementation of the new financial system.
45. The compiling of the annual report, completion of a risk assessment and the implementation of SCOPA resolutions were not completed due to the accounting officer not prioritising these matters.

Investigations

46. In terms of *General Notice R40* published in *Government Gazette No. 30521 of 27 November 2007*, the President of the Republic of South Africa requested an investigation into several matters concerning the affairs of the municipality. As this

investigation has not reached finality, it is not known what impact, if any, the matter under investigation could have on the financial transactions or whether it would result in the Maluti-a-Phofung Local Municipality incurring losses. This matter will be reported on once the investigation has been finalised.

47. The South African Police Service is currently conducting an investigation into the procurement of services by the municipality for the development and implementation of a website.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

48. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

49. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

50. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
51. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
52. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

Lack of reporting on all predetermined objectives in annual report

53. The Maluti-a-Phofung Local Municipality has not reported on all the predetermined objectives as required by section 46 of the MSA. Infrastructure and community development objectives set in the integrated development plan were not compared in detail to objectives achieved. No measures to improve the performance of the municipality were documented in the performance report. This is an indication of the staff's attitude towards responsibility and capacity to report on performance information.

APPRECIATION

54. The assistance rendered by the staff of the Maluti-a-Phofung Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

30 November 2009



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
THE COUNCIL OF MALUTI-A-PHOFUNG LOCAL MUNICIPALITY ON THE
FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF MALUTI-A-
PHOFUNG WATER (PTY) LTD FOR THE YEAR ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of Maluti-a-Phofung Water (Pty) Ltd which comprise the statement of financial position as at 30 June 2009, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes and the directors' report, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Companies Act of South Africa, 1973 (Act No. 61 of 1973) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by Maluti-a-Phofung Water (Pty) Ltd in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis for disclaimer of opinion

Property, plant and equipment

5. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation, presentation and disclosure of, and the municipal entity's rights to, property, plant and equipment with a carrying value of R5 368 362 (2008: R5 816 707) presented in the statement of financial position and disclosed in note 4 to the financial statements:
- (a) The descriptions, serial numbers, location and condition of assets as indicated in the fixed asset register were inadequate and the individual assets were not adequately numbered. Since the municipal entity's records did not permit the performance of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to obtain adequate audit assurance.
 - (b) According to paragraphs 30, 51 and 63 of the International Accounting Standard, IAS 16 *Property, plant and equipment* (IAS 16), at the end of every financial year management are required to review the residual values and useful lives of assets classified as property, plant and equipment, and to assess whether any indication exists that such assets may be impaired. The management of Maluti-a-Phofung Water (Pty) Ltd did not perform the prescribed reviews and assessments regarding property, plant and equipment for either the current or the previous financial year. The entity's records for the years ended 30 June 2008 and 30 June 2009 did not permit the application of reasonable alternative audit procedures in this regard. As a result, I was unable to obtain all the information and explanations I considered necessary to obtain adequate assurance as to the valuation of property, plant and equipment and the accuracy and completeness of depreciation and impairment of assets included in operating expenses for the current and previous financial year.
 - (c) The management of the entity did not provide me with sufficient appropriate audit evidence that assets with a cost price of R3 234 559, that were transferred to Maluti-a-Phofung Water (Pty) Ltd from the Maluti-a-Phofung Local Municipality upon establishment of the municipal entity, were subject to a fair value evaluation and were recorded at fair value when the entity was formed, as required by paragraph 36 of the International Financial Reporting Standard, IFRS 3 *Business Combinations*. Since the entity's records did not permit the application of reasonable alternative audit procedures in this regard, I was unable to obtain all the information and explanations I considered necessary regarding the valuation of these assets.

Trade and other receivables

6. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the valuation and classification of trade and other receivables with a carrying value of R13 690 171 (2008: R17 968 217) presented in the statement of financial position and disclosed in note 2 to the financial statements:
- (a) The receivable for Maluti-a-Phofung Local Municipality amounting to R13 690 171 (2008: R17 968 217) could not be confirmed with the municipality. The entity's records did not permit the application of reasonable alternative audit procedures regarding this receivable. Consequently, I did not obtain all the information and explanations I considered necessary regarding the Maluti-a-Phofung Local Municipality debtor.
 - (b) Paragraphs 43 and 46 of the International Accounting Standard, IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) requires that receivables have to be initially measured at fair value and subsequently measured at amortised cost using the effective interest method. Contrary to these requirements, due to an oversight by management, trade and other receivables were not initially measured at fair value and subsequently measured at amortised cost using the effective interest method. Because the relevant information is not available, I am not able to determine the amount by which trade and other receivables and interest received are overstated. The entity's records did not allow the performance of reasonable alternative procedures to reliably determine these amounts.
 - (c) Adequate supporting documentation could not be obtained for journals that had a net credit impact of R3 968 120 (2008: R61 067 559) on trade and other receivables. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these journals. I could therefore not determine whether these journals existed and were accurately recorded and I could not gain adequate audit assurance as to the valuation and classification of trade and other receivables.

Revenue

7. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the occurrence, completeness, accuracy, cut-off and classification of revenue with a value of R26 518 582 (2008: R33 414 050) as disclosed in the statement of financial performance and note 7 to the financial statements:
- (a) In terms of the contract between the entity and the parent municipality, the entity only becomes entitled to receive payment for the delivery of water and sewerage services once the municipality has received payment from the consumers. In accordance with paragraph 9 of the International Accounting Standard, IAS 18 *Revenue* (IAS 18), revenue is recognised when the money is received by the municipality from the consumers. Detailed information could not be submitted with

regard to the receipts from consumers by the municipality and the adjustments processed with regard to these receipts. The entity's records did not permit the application of reasonable alternative audit procedures with regard to revenue. Consequently, I did not obtain all the information and explanations I considered necessary with regard to revenue amounting to R26 518 582 (2008: R33 414 050).

- (b) Contrary to paragraph 9 of IAS 18, service charges were not measured at the fair value of the consideration received or receivable due to an oversight by management. Because the relevant information is not available, I am not able to determine the amount by which service charges are overstated and interest received is understated. The entity's records did not permit the performance of reasonable alternative procedures to reliably determine these amounts.
- (c) Adequate supporting documentation could not be obtained for journals that have a net debit impact of R7 305 368 (2008: R7 069 140) on revenue. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these journals. I could therefore not determine whether these journals occurred and were accurately recorded and I could not gain adequate audit assurance as to the accuracy and classification of revenue

Inventory

- 8. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to gain adequate audit assurance as to the completeness, existence, valuation, presentation and disclosure of, and the entity's rights to, inventory with a carrying value of R3 819 319 (2008: R2 643 255) as disclosed in the statement of financial performance and note 3 to the financial statements for the current and the prior year:
 - (a) In the prior year an inventory list that includes the inventory code, description, quantity on hand and value per unit could not be submitted. The entity's records did not permit the application of reasonable alternative audit procedures regarding the comparative amount with regard to inventories. Consequently, I did not obtain all the information and explanations I considered necessary regarding the completeness, existence and valuation of, and the entity's rights to, inventory as disclosed in the comparative figures.
 - (b) In terms of paragraph 6 of the International Accounting Standard, IAS 2 *Inventories* (IAS 2), water reserves that were held for resale via the network should be recognised as inventory. However, the water reserves included in the water network were not recognised as inventory during the year under review and the prior year. The entity's records did not permit the application of reasonable alternative audit procedures regarding the water reserves. Accordingly, I was not able to determine the amount by which inventory is understated and cost of sales is overstated in the current and prior year.
 - (c) Paragraph 9 of IAS 2 requires that inventories have to be measured at the lower of cost and net realisable value. In the prior year management did not evaluate the carrying value of inventory at year-end to ensure that inventory is disclosed at the

lower of cost and net realisable value. The entity's records did not permit the application of reasonable alternative audit procedures regarding the carrying value of inventory as disclosed in the comparative figures. Accordingly, I was not able to determine the amount by which inventory and operating expenses are misstated in the prior year.

- (d) In the prior year a number of variance reports that resulted from stock counts that had been performed could not be submitted to substantiate the stock adjustments recognised in the detailed ledger amounting to R3 365 523. The entity's records did not permit the application of reasonable alternative audit procedures regarding the stock adjustments in the prior year. Consequently, I did not obtain all the information and explanations I considered necessary, regarding the accuracy, completeness and occurrence of the stock adjustments, the valuation of inventory and the accuracy of operating expenses in the comparative figures.
- (e) Adequate supporting documentation could not be obtained for journals that have a net credit impact of R859 963 (2008: debit impact of R1 464 468) on inventory. The entity's records did not permit the performance of reasonable alternative audit procedures regarding these journals. I could therefore not determine whether these journals existed and were accurately recorded and I could not gain adequate audit assurance as to the valuation of inventory for the current and prior year.

Trade and other payables

- 9. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of, and the municipal entity's obligations to, trade and other payables with a carrying value of R28 491 981 (2008: R18 701 341) presented in the statement of financial position and disclosed in note 5 to the financial statements:
 - (a) I was unable to obtain sufficient appropriate audit evidence in respect of trade creditors amounting to R21 243 036 (2008: R13 028 978) that were included in the trade and other payables disclosed in note 5 to the financial statements. The entity's records did not permit the application of reasonable alternative audit procedures regarding purchases accruals. Consequently, I did not obtain all the information and explanations I considered necessary regarding these payables and whether the payables represent obligations of the entity as well as the accuracy, completeness, occurrence and cut-off of cost of sales.
 - (b) Adequate supporting documentation could not be obtained for journals that have a debit impact of R359 250 (2008: credit impact of R3 290 308) on trade and other payables. The entity's records did not permit the performance of reasonable alternative audit procedures regarding these journals. I could therefore not determine whether these journals existed and were accurately recorded and I could not gain adequate audit assurance as to the valuation of trade and other payables.
 - (c) Paragraphs 43 and 47 of IAS 39 require that financial liabilities have to be initially measured at fair value and subsequently measured at amortised cost using the

effective interest method. Contrary to these requirements, due to an oversight by management, trade and other payables were not initially measured at fair value and subsequently measured at amortised cost using the effective interest method in the current and prior year. Because the relevant information is not available, I am not able to determine the amount by which trade and other payables and interest paid are overstated in the current and prior year. The entity's records did not allow the performance of reasonable alternative procedures to reliably determine these amounts.

- (d) In the prior year an amount of R383 694 was owed by the entity to Maluti-a-Phofung Local Municipality regarding deposits that were made by consumers into the bank account of the entity that should have been deposited into the bank account of the municipality. At prior year-end the balance of the relevant control account was R nil because it was incorrectly cleared to operating expenditure due to an oversight by management. Consequently, trade and other payables and operating expenses are understated by R383 694 in the comparative figures. Furthermore, the error has not been corrected in the current year. Consequently, trade and other payables and the accumulated deficit are understated by R383 694.
- (e) Payments made after 30 June 2008 amounting to R976 046 related to expenditure incurred by the company in the 2007-08 financial year, which was not recognised as payables in the comparative figures. Furthermore, during the 2006-07 financial year's audit, invoices amounting to R587 252 were identified that were not recognised in the 2006-07 financial year, although they related to that financial year. This resulted in payables being understated by R976 046, operating expenditure being understated by R341 047, the VAT liability being overstated by R119 865 and the opening balance of accumulated surplus being overstated by R515 134 in the comparative figures. Furthermore, expenditure is overstated by R856 181 in the current financial year.
- (f) Due to an error in the way that the payroll system calculates the leave accrual, the leave accrual that is included in trade and other payables in note 5 to the financial statements and employee-related cost that is included in the statement of financial performance are understated by R692 779. Furthermore, due to the fact that incorrect leave days were used to calculate the comparative amount of the leave accrual, the comparative amount of the leave accrual and the comparative amount of employee-related cost are understated by R762 393.
- (g) Paragraph 17 of IAS 19 (AC116), *Employee Benefits*, requires an entity to recognise the expected cost of bonus payments as an accrued expense. Due to an oversight by management, the entity did not accrue the expected cost of bonus payments at year-end. Consequently, accruals that are included in trade and other payables in note 5 to the financial statements and employee-related cost as disclosed in the statement of financial performance are understated by R930 836.

Expenditure

10. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the occurrence, accuracy and classification of operating expenses with a value of R7 268 781 (2008: R7 728 701) presented in the statement of financial performance and disclosed in note 16 to the financial statements:
 - (a) Supporting documentation with regard to operating expenditure amounting to R393 531 could not be submitted in the prior year. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these expenses. Consequently, I did not obtain all the information and explanations I considered necessary regarding of operating expenditure in the comparative figures.
 - (b) The relevant contracts for payments totalling R1 102 600 in respect of operating expenditure were not submitted in the prior year. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these payments. I could therefore not determine whether these payments occurred and could not gain adequate audit assurance as to the occurrence of expenditure and that irregular expenditure was not incurred in the prior year.
 - (c) All the relevant tender documentation for payments totalling R746 833 in respect of operating expenditure was not submitted in the prior year. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these tender documents. I could therefore not determine whether the supply chain management policy was followed in all respects with regard to the awarding of these tenders and that irregular expenditure was not incurred in the prior year.
 - (d) Paragraph 7 of IAS 16 requires that the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. Contrary to this requirement, expenditure relating to items of property, plant and equipment amounting to R762 972 (2008: R826 061) was included in expenses in the statement of financial performance. This is as a result of the wrong interpretation of the requirements of IAS 16 by management. Consequently, operating expenditure is overstated by R762 972 (2008: R826 061) and property, plant and equipment are understated by R1 589 033.
11. Paragraph 43 of IAS 39, requires that financial liabilities have to be initially measured at fair value. This implies that the related expense also has to be recognised at fair value. Contrary to this requirement, due to an oversight by management, expenditure with regard to water purchases was not measured at fair value. Because the relevant information is not available, I am not able to determine the amount by which water purchases are overstated and interest paid are understated as reflected in notes 14 and 15 of the financial statements. The entity's records did not allow the performance of reasonable alternative procedures to reliably determine these amounts.

12. Adequate supporting documentation could not be obtained for journals that have a net credit impact of R2 836 535 (2008: net debit impact of R2 034 306) on expenses. The municipality's records did not permit the performance of alternative audit procedures regarding these journals. I could therefore not determine whether these journals occurred and were accurately recorded and I could not gain adequate audit assurance as to the accuracy and classification of expenses.
13. In accordance with paragraph 104 of the Standard of Generally Recognised Accounting practice, GRAP 1 *Presentation of Financial Statements*, the entity presents its statement of financial performance by using the nature of expense method. Contrary to this method, travel allowances amounting to R3 411 290 were incorrectly allocated to repairs and maintenance due to an oversight by management. Consequently, employee-related cost is understated by R3 411 290 and repairs and maintenance are overstated by the same amount.

Value-added tax (VAT)

14. Section 7 of the Value-added Tax Act, 1991 (Act No. 89 of 1991) (VAT Act) requires that VAT has to be levied on the supply by any vendor of goods or services in the course or furtherance of any enterprise carried on by him. Contrary to this requirement, VAT of R506 800 was not levied on invoices issued to the parent municipality in the prior year with regard to the supply of water and sewerage services due to an oversight by management. Consequently, the outstanding VAT balance included in trade and other payables is understated by R506 800 and revenue is overstated by the same amount in the comparative figures. Furthermore, the error was not corrected in the current year. Consequently, the outstanding VAT balance included in trade and other payables and accumulated deficit are understated by R506 800 in the current year.
15. In terms of section 5A of the VAT Act, a vendor shall be deemed to supply services to any municipality to the extent of any grant paid to, or on behalf of, that vendor in respect of the taxable supply of goods or services by that vendor. Contrary to this requirement VAT of R926 586 (2008: R5 574 316) was not levied on invoices that were issued to the parent municipality with regard to grants that were paid to the entity due to an oversight by management. Consequently, the outstanding VAT balance included in trade and other payables is understated by R6 500 902 (2008: R5 574 316), revenue is overstated by R926 586 and accumulated deficit is overstated by R5 574 316.

Irregular expenditure

16. In terms of section 1 of the MFMA a municipal entity incurs irregular expenditure, *inter alia*, when the expenditure is in contravention of the MFMA or of the entity's supply chain management policy. In terms of this definition, irregular expenditure amounting to R208 996 was incurred in the prior year because the number of written quotations as required by the supply chain management policy was not obtained. Furthermore, the expenditure was not disclosed in the financial statements as irregular expenditure as required by section 125(2)(d) of the MFMA.

17. A tender was awarded for the implementation of a performance management system and the minutes of the bid committee meetings could not be submitted in the prior year. An amount of R227 188 was paid in terms of this tender during the prior year and an amount of R514 140 was paid during the current year. The entity's records did not permit the application of reasonable alternative procedures regarding these meetings. Consequently, I could not obtain all the information and explanations I considered necessary, regarding the fact that irregular expenditure of R514 140 (2008: R227 188) had not been incurred by the entity in the prior and current years. Furthermore, the expenditure was not disclosed in the financial statements as irregular expenditure as required by section 125(2)(d) of the MFMA.

Cash flow statement

18. I was not able to determine whether the cash flow statement and the related notes are fairly stated due to the material effect of scope limitations and identified misstatements as reported in this report on the cash flow statement and related notes.

Disclaimer of opinion

19. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Maluti-a-Phofung Water (Pty) Ltd. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matters on which I do not express a disclaimer of opinion:

Basis of accounting

20. The municipal entity's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Fruitless and wasteful expenditure

21. As disclosed in note 20 to the financial statements, fruitless and wasteful expenditure to the amount of R56 388 was incurred due to penalties and interest incurred on the late payment of employees' tax to SARS.

Restatement of corresponding figures

22. As disclosed in note 19 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of errors discovered during 2008-09 in the financial statements of Maluti-a-Phofung Water (Pty) Ltd at, and for the year ended, 30 June 2008.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

23. The municipal entity provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 *Presentation of Financial Statements*. The supplementary budget information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2000 (Act No. 32 of 2000) (MFMA)

24. Contrary to section 99(2)(b) of the MFMA, invoices amounting to R354 071 (2008: R1 561 790) were not paid within 30 days of receipt of the invoice.

Governance framework

25. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

26. Section 95(c)(i) of the MFMA states that the accounting officer must ensure that the municipal entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control (the number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

| Par. no. | Basis for disclaimer of opinion | CE | RA | CA | IC | M |
|----------|---------------------------------|----|----|-------|----|-----|
| 5 | Property, plant and equipment | 5 | | 5,6 | | 1,3 |
| 6 | Trade and other receivables | 5 | | 3,4,5 | | 1,3 |
| 7 | Revenue | 5 | | 3,4,6 | | 1,3 |

| Par. no. | Basis for disclaimer of opinion | CE | RA | CA | IC | M |
|----------|---------------------------------|----|----|-------|----|-----|
| 8 | Inventory | 5 | | 4 | | 1,3 |
| 9 | Trade and other payables | 5 | | 3,4,6 | | 1,3 |
| 10 - 13 | Expenditure | 5 | | 5 | | 1,3 |
| 14 - 15 | Value-added tax | 5 | | 6 | | 1,3 |
| 16 - 17 | Irregular expenditure | 5 | | 3 | | 1,3 |
| 18 | Cash flow statement | 5 | | 5 | | |

Overall reflections on the governance framework based on internal control deficiencies

27. The entity has human resource constraints due to limited resources and prolonged leave of a key staff member in the finance department, resulting in pressure on the remaining financial staff. A lack of relevant skills by the personnel responsible for the inventory system was evident.
28. A chief financial officer was only appointed after year end, resulting in insufficient segregation of duties in the finance department.
29. The relationship between the entity and the parent municipality does not support the business objectives and proper oversight was not provided by the parent municipality on matters of governance and financial reporting.

| Legend | |
|---|---|
| CE – Control environment | |
| The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting. | 1 |
| Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting. | 2 |
| Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel. | 3 |
| Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting. | 4 |
| The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control. | 5 |
| Management's philosophy and operating style do not promote effective control over financial reporting. | 6 |
| The entity does not have individuals competent in financial reporting and related matters. | 7 |
| RA – Risk assessment | |
| Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting. | 1 |
| The entity does not identify risks to the achievement of financial reporting objectives. | 2 |
| The entity does not analyse the likelihood and impact of the risks identified. | 3 |
| The entity does not determine a risk strategy/action plan to manage identified risks. | 4 |
| The potential for material misstatement due to fraud is not considered. | 5 |
| CA – Control activities | |
| There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation. | 1 |
| General information technology controls have not been designed to maintain the integrity of the information system and the security of the data. | 2 |
| Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed. | 3 |
| Actions are not taken to address risks to the achievement of financial reporting objectives. | 4 |
| Control activities are not selected and developed to mitigate risks over financial reporting. | 5 |

| | |
|--|---|
| Policies and procedures related to financial reporting are not established and communicated. | 6 |
| Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system. | 7 |
| IC = Information and communication | |
| Pertinent information is not identified and captured in a form and time frame to support financial reporting. | 1 |
| Information required to implement internal control is not available to personnel to enable internal control responsibilities. | 2 |
| Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel. | 3 |
| M = Monitoring | |
| Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting. | 1 |
| Neither reviews by internal audit or the audit committee nor self-assessments are evident. | 2 |
| Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken. | 3 |

Key governance responsibilities

30. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

| No. | Matter | Y | N |
|---|--|---|---|
| Clear trail of supporting documentation that is easily available and provided in a timely manner | | | |
| 1. | No significant difficulties were experienced during the audit concerning delays or the availability of requested information. | | X |
| Quality of financial statements and related management information | | | |
| 2. | The financial statements were not subject to any material amendments resulting from the audit. | | X |
| 3. | The annual report was submitted for consideration prior to the tabling of the auditor's report. | X | |
| Timeliness of financial statements and management information | | | |
| 4. | The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA. | X | |
| Availability of key officials during audit | | | |
| 5. | Key officials were available throughout the audit process. | X | |
| Development and compliance with risk management, effective internal control and governance practices | | | |
| 6. | Audit committee | | |
| | <ul style="list-style-type: none"> The municipal entity had an audit committee in operation throughout the financial year. The audit committee operates in accordance with approved, written terms of reference. The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. | | X |
| 7. | Internal audit | | |

| | | | |
|--|--|---|---|
| | <ul style="list-style-type: none"> The municipal entity had an internal audit function in operation throughout the financial year. | | X |
| | <ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. | | X |
| | <ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. | | X |
| 8. | There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management. | | X |
| 9. | There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations. | | X |
| 10. | The information systems were appropriate to facilitate the preparation of the financial statements. | X | |
| 11. | A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 95(c)(i) of the MFMA. | | X |
| 12. | Powers and duties have been assigned as set out in section 106 of the MFMA. | X | |
| Follow-up of audit findings | | | |
| 13. | The prior year audit findings have been substantially addressed. | | X |
| 14. | SCOPA resolutions have been substantially implemented. | X | |
| Issues relating to the reporting of performance information | | | |
| 15. | The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete. | | X |
| 16. | Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information. | | X |
| 17. | A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by Maluti-a-Phofung Water (Pty) Ltd against its mandate, predetermined objectives, outputs, indicators and targets in accordance with section 87 of the MFMA. | X | |
| 18. | There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance. | X | |

Overall reflections on the governance framework based on other key governance requirements

31. Capacity constraints in the finance department and a lack of leadership, oversight and direction by the accounting officer resulted in expected supporting documentation not being available and material amendments to the financial statements as it was not properly reviewed by the finance manager.
32. The board of directors did not fulfil its governance oversight and the shared audit committee and internal audit function with the parent municipality did not function effectively. This had the result that there were insufficient implementation and monitoring of internal control in respect of financial management, risk management and compliance with laws and regulations. Furthermore, the action plan to address previous year audit findings was not diligently executed by the finance manager and monitored by the accounting officer.

33. Management did not prioritise the development and implementation of a performance management system to effectively monitor service delivery in terms of the service level agreement.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

34. I was engaged to review the performance information.

The accounting officer's responsibility for performance information

35. In terms of section 121(4)(d) of the MFMA, the annual report of a municipal entity must include an assessment by the entity's accounting officer of the entity's performance against any measurable performance objectives set in terms of the service delivery agreement or other agreement between the entity and its parent municipality.

The Auditor-General's responsibility

36. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*.
37. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
38. I believe that the evidence I have obtained is sufficient and appropriate to report that no significant findings have been identified as a result of my audit.

APPRECIATION

39. The assistance rendered by the staff of Maluti-a-Phofung Water (Pty) Ltd during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

30 November 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence